1812

THE NATIONAL CITY BANK OF NEW YORK

1949

Monthly Letter on

Economic Conditions
Government Finance

New York, May, 1949

General Business Conditions

THE business reports during April have not shown the improvement which some observers hoped for. The opening up of outdoor work and such seasonal influences as increasing automobile sales and output have helped offset slackening elsewhere, and the rise in unemployment has been checked since early March. The upturn in construction contract awards which began in February also has carried further. But despite these favorable trends, the situation shows numerous soft spots and few signs of pick-up in them. Expectations of a Spring rush of new orders have not been realized in any general way, and further declines in prices of industrial materials and products show that on the whole demand still lags. Probably the most noteworthy development of the month is the appearance of easing in the steel industry. The falling off in operations is slight, but it is the first decline in several years that has been caused by slackening demand.

Industrial production in the aggregate declined in March partly because of the bituminous coal shutdown. In April coal mining has been resumed, but with steel off a little and further cutbacks in some other lines, the month's figures, when they can be totalled up, apparently will be no better than those of March. The weight given to steel output in overall production indexes such as that of the Federal Reserve Board almost guarantees that they will work downward if steel operations decline. However, the backlog of unfilled orders for steel is immense. Predictions of any material drop in output usually relate to the latter part of the year rather than the early future.

With the Spring pickup sluggish, Washington views of the business outlook seem to be changing. Two members of the Council of Economic Advisers had expected inflationary pressures to reassert themselves this Spring, but official policy now tends the other way. The Board of Governors of the Federal Reserve System during the month has relaxed installment buying regulations again and has reduced the percentages of reserves required to be carried against deposits by its member banks. This is notice that the Governors do not intend that deflationary forces shall be accentuated by credit restrictions or scarcity.

Effects of Shortening Commitments

The dominating influence in the industrial news is the effort all along the line to reduce inventories and shorten commitments. In part this policy has been adopted because of a drop in consumer demand for the end-product, as in furnishings and appliances. However, personal income and expenditures are holding up relatively better than other business figures, and April has been a better month than March in department store, chain and mail order sales. The more general reason for shortening inventory is that production has caught up, pipelines are filled, deliveries are much more certain and prompt, and neither manufacturers nor distribu-

CONTENTS

tors need to be covered ahead as they have been during the past two years. In railroad equipment and similar capital goods industries, falling orders lead promptly to reduced purchases. At the same time, and in part for the same reasons, the price outlook has changed. Expectation of lower prices promotes caution.

This change in buying policy has a multiplied effect as it works down the line. When a manufacturer of automobiles, for example, decides to reduce his coverage his purchases of supplies and materials may drop for a time to zero, and when this situation is widespread the new orders received by primary producers may almost disappear. In some degree, this is what is happening. The automobile industry is making and selling more vehicles than since 1941 — in some cases, since 1929 — and is using up materials accordingly. But it has shortened commitments to curtail inventory, and the non-ferrous metal industries particularly have had a sharp drop in orders from automotive buyers.

Another illustration of the effects of inventory shortening is in the battery business. Over forty million automobiles, more than ever before, are on the road, and more batteries are being used up than ever before. But shipments of replacement batteries were only 826,000 in February and 555,000 in March. It is certain that these figures are far below the average rate of use, and that distributors' stocks are coming down.

In due course both the situations cited will right themselves. When the inventories and commitments of the automobile manufacturers are brought down to the desired point, buying will have to recover to the level of current use. When distributors' stocks of batteries are sufficiently reduced, which ought to happen within the next two or three months, battery shipments must rise sharply. In these and similar areas, therefore, improvement is to be expected.

A roll call of the industries would show that some are well along in adjusting themselves to changed conditions, by curtailing production, reducing prices and getting control of inventories. The cutback in cotton goods, rayon, woolens, petroleum, brass and leather has been sharp. In the larger retailing organizations, including department stores, chains and mail order houses, stocks have been brought down moderately and forward orders cut sharply. It would be premature to say that curtailment has run its course in any line, but correction is under way. On the other hand, some industries, operating full against backlogs but seeing their orders declining, have adjustments ahead.

Working Out New Relationships

Any business decline, particularly one which occurs without real tightness of money and in the face of a strong and liquid financial situation, is evidence that economic relationships have become unbalanced. The drop is part of the process of working out new relationships. Swollen by monetary inflation and war-caused scarcities, demand has been abnormally high, and industrial production has been abnormally high in the effort to satisfy it. Activity cannot be maintained at recent peak levels in all parts of the economy because the demand for specific types of goods is not sufficiently elastic. Replacement needs become saturated and pipelines become filled. Therefore curtailment of production and price reductions in specific areas is part of the process of balancing the markets.

In the economic system of this country the curtailment will be accomplished in the most beneficial way possible, namely, by competitive forces which will compel the least efficient and highest cost producers to bear the brunt of it. This is hard on the people affected, and particularly upon those who have entered business since the war without the experience, ability or capital necessary to make a success. It is among them that most current business failures are occurring. But if the general welfare is to be promoted, and the historical rise in living standards carried on, production and distribution have to be by the most efficient and lowest cost agencies, in order that goods may be sold at the lowest possible prices and reach the broadest possible markets. This shaking down is one type of adjustment that the economy is now going through. It applies not only to employers but to workers, for employment also has been abnormally high during inflation, and relatively inefficient people have been drawn into the labor force to do work for which they were not well qualified.

The second type of adjustment is that business must fit its output to consumers' wants. It must find a way to make the goods wanted at prices that people can and will pay. In a sellers' market the buyer must take what he can get at the price asked; but in a buyers' market he buys what he wants, or what he can be induced to want, at a price he can pay. When industry meets those conditions it finds that consumers' wants in the aggregate are unlimited.

The Practical Requirements

The practical requirements now are to make production more efficient, to get prices down, and to resume selling. During the inflation many

people lost purchasing power. Everyone who lived upon a fixed or relatively fixed income, including pensioners of all kinds and those living chiefly upon the return from investments, was a victim of inflation. So were all people whose wage or salary increases lagged behind the rise in the cost of living. The important thing now is to bring all these people back into the market by improving their purchasing power. This means reducing production costs and prices of goods through greater productivity.

The greatest possible obstacle toward restoring the economic balance in this respect would be a further increase in money wage rates. It would raise costs, force up prices at the expense of all who did not obtain the increases, or accentuate the drop in profits and further reduce the incentive and means to make capital expenditures. Under the conditions now existing it would almost surely increase unemployment.

If the nature of these necessary adjustments is understood and people approach them with understanding and cooperation rather than complaint and resistance, the decline in business will end in a more normal, healthful and balanced condition, from which progress can be resumed. The cushions, which will operate to support the economy from declining beyond that desirable state into a spiral of unemployment and financial loss, are immensely strong. They include, as these Letters have so often pointed out, an unprecedented accumulation of U. S. Savings Bonds and other liquid savings by individuals which can be drawn upon to supplement current income and maintain buying. They include generally low ratios of debt to assets, absence of stock market inflation and of speculative excesses generally, and lack of credit stringency. They include unemployment compensation and other income payments which increase automatically as incomes from wage and salary payments or from farm marketings decline. They include the unshrinking segment of demand, both for home use and for export, which is represented by government expenditures.

In these supports a reason for relative optimism is to be found. They warrant hope that adjustments can be worked out and the economy brought into balance on a high rather than a low level. There is no lack of work to be done. The problem is to establish terms of trade — wage, cost and price relationships — on which people can exchange their work, and to maintain an environment of order and confidence in which enterprise can thrive.

First Quarter Earnings

Reports of industrial corporations thus far available for the first quarter make, in general, a better showing than had been anticipated. Despite the pessimistic tone of much business comment since the latter part of 1948, and notwithstanding sharp declines in commodity prices and reports of increasing cutbacks in production in many lines, industry as a whole appears to have come through the quarter with a level of net earnings close to, if not actually somewhat above, that of the first quarter a year ago.

Our tabulation of 500 reports published to date shows a composite net income of 6 per cent greater than for the same companies in the March quarter last year, though 18 per cent smaller than in the final quarter of 1948. This group is mainly representative of the larger manufacturing organizations but includes also a limited number of reports of companies in the mining, trade, and service industries.

The increase in the total net income over a year ago was accounted for in large measure by the marked gains in the steel and automobile groups. The figures in these industries weigh heavily in the total results. But even excluding the steel and motor car companies, earnings of the remaining 452 companies so far reporting came within 8 per cent of last year's level.

The aggregate totals conceal highly diverse trends developing among different industries and among individual companies as a result of the rapidly changing complexion of the business situation. Many companies in a variety of lines, where sales were beginning to slip or where prices had been lowered, found earnings dipping moderately under a year ago. For companies in lines such as textiles and apparel, where cutbacks in production had gone far, the decline in earnings was severe. Owing to the limited number of quarterly reports published by manufacturers in many of the soft goods lines, the severe declines experienced in these industries are not fully reflected in the composite totals.

Illustrating further the wide divergence of earnings trends, the companies were about evenly divided as to the numbers which showed increases and decreases from a year ago. Compared with the fourth quarter of 1948, approximately three-fourths of the companies showed decreases, as against one-fourth showing increases.

Aggregate dollar sales of all manufacturing companies reporting sales were 9 per cent above last year. As compared with the peak fourth quarter of 1948, there was a decrease, partly seasonal, in total sales amounting to 7 per cent.

NET INCOME OF LEADING CORPORATIONS FOR THE FIRST QUARTER
(In Thousands of Dollars)

No. of Cos.	Industry Groups	Reported Net Income First Qr. 1948	Reported Net Income Fourth Qr. 1948	Reported Net Income First Qr. 1949	Per Cent Change From First Qr. 1948	Per Cent Change From Fourth Qr. 1948
25	Food products	$ 36,700	$ 42,554	$ 34,028	— 7.3	—20.0
28	Textiles and apparel	36,584	34,206	17,603	—51.9	—48.5
21	Pulp and paper products	20,918	20,655	15,735	—24.8	—23.8
43	Chemicals, drugs, etc	110,637	141,565	124,590	+12.6	—12.0
16	Petroleum products	186,935	225,018	162,407	—13.1	—27.8
22	Cement, glass, and stone	29,847	42,708	33,446	+12.1	—21.7
38	Iron and steel	111,935	189,862	185,759	+66.0	— 2.2
13	Building, heating, plumbing equipment	8,722	16.560	4,879	—44.1	—70.5
16	Electrical equipment and radio	45,517	67,514	44,731	— 1.7	—33.7
39	Machinery	21,192	33,439	26,143	+23.4	—21.8
9	Office equipment	17,191	16,893	15,327	—10.8	— 9.3
10	Autos and trucks	107,774	132,235	152,878	+41.9	+15.6
26	Automobile parts	26,739	34,606	27,046	+ 1.1	—21.8
9	Railway equipment	8,446	10,503	10,803	+27.9	+ 2.9
60	Other metal products	53,949	72,135	53,654	— 0.5	—25.6
44	Miscellaneous manufacturing	52,926	64,396	44,443	—16.0	—31.0
419	Total manufacturing	876,012	1,144,849	953,472	+ 8.8	—16.7
36	Mining and quarrying	40,057*	49,091*	33,586*	—16.2	—31.6
25	Trade (retail and wholesale)	28,680	36,127	18,233	—36.4	—49.5
20	Service industries	10,049	12,217	11,138	+10.8	— 8.8
500	Total	$954,798	$1,242,284	$1,016,429	+ 6.5	—18.2

*Before depletion charges in some cases.

A condensed summary by major industrial groups is given in the accompanying table. With the prevailing downward trend of prices and sales, it is generally expected that for most lines not already readjusted to a more normal supply-demand and competitive condition, the first quarter profits may mark the high-water mark of the year.

Trends by Industries

In the steel industry, physical output in the first quarter was 9 per cent above last year, reflecting the increased heavy investment in plant and equipment which the industry was able to utilize at full capacity, and net income of 38 reporting companies increased by 66 per cent. In the automobile industry, the output of cars and trucks was 7 per cent above last year, and net income of 10 companies was up 42 per cent. Even in these groups, however, gains were by no means universal, with several of the steel producers and truck manufacturers, whose peak business was passed last year, showing decreased earnings. A few incurred actual deficits.

Other metal products, including nonferrous metal fabricators, which showed practically no change in the aggregate net income, had 38 companies showing decreases against 22 showing increases. Despite the slump in the electrical appliance business during the first quarter, earnings of 16 manufacturers of electrical equipment, including television, held about even with last year's high level.

The aircraft industry is having a particularly sharp recovery in sales and earnings, from the low level to which it was curtailed after the war, in connection with the enlarged national defense program, which is expected to benefit also numerous other lines producing military equipment and supplies.

Among industries reporting decreased earnings, a group of 16 petroleum refiners showed a decline of 13 per cent in net income, reflecting a temporary oversupply of petroleum products resulting from the greatly expanded productive capacity combined with the mild winter in the eastern section of the country, which led to a series of reductions in fuel oil prices. Lower earnings were reported also by a majority of companies in the food products, pulp and paper, and miscellaneous manufacturing groups.

The consumers' goods fields generally have become subject to increasing competition as the heavy postwar production of goods caught up with the deferred demands accumulated during the war. As a result, their volume of sales has slowed down somewhat and greater selling efforts have been needed, as well as price reductions in many cases, in order to keep goods moving. These developments, together with high break-even points, the inflexibility of certain types of expenses, and inventory write-downs in a few instances, have squeezed manufacturers' profit margins. A group of 25 retail trade organizations that have reported also showed lower earnings in most cases.

A Long-Range View of Profits

In the discussion of year-to-year changes in business earnings, and disputes over whether profits are "too high" and how they might be divided, there is a tendency to overlook the long-range results of profits retained in the industries in the building of more and better products that everyone can use. An impressive example of the way in which the public at large shares in the benefits of profits ploughed back into enlarg-

ing and improving the facilities of production is afforded by the accompanying table from the General Motors' 1948 annual report, covering a forty-year period of passenger car development and comparing the 1908 Cadillac with the 1928 Buick and the 1948 Chevrolet:

Comparison of General Motors Passenger Cars, 1908-48

	1908 Cadillac	1928 Buick*	1948 Chevrolet
Manufacturer's List Price	$2,000	$1,320	$1,280
Horsepower	25	74	90
Maximum Speed	50 MPH	65 MPH	82 MPH
Fuel Economy (miles per gal. at 30 MPH)	**	14.7	22.7
Curb Weight	2,250 lbs.	3,764 lbs.	3,225 lbs.
Number of Cylinders	4	6	6
Wheel Base	100"	115.75"	116"

* 1929 model Buick, introduced in July, 1928.
** Not available.

It will be seen that the 1948 Chevrolet was lower in price, even in terms of inflated dollars, than the Buick of twenty years ago, or the Cadillac of forty years ago. Yet, as brought out in the table, it is much more car by every test. Moreover, the table does not begin to reflect such improvements in modern automobile design as all-steel bodies, four-wheel brakes, shatterproof glass, etc., all making for greater comfort, safety, and dependability.

Whereas in 1910, two years after General Motors was started, there were 10,000 employes, today the Corporation employs more than 380,000 men and women. The report calls attention to the fact that forty years ago a job in an auto plant, while a good job, meant as many as 60 hours of work per week. Since then, hours have been reduced to a standard of 40 hours per week, earnings increased, and heavy physical work reduced by the use of machinery. Safety and working conditions have been greatly improved. Employes enjoy paid vacations and holidays, group insurance, and other job benefits unheard of forty years ago.

This record of achievement is but a sample of what has been done also by Ford, Chrysler, and other automobile manufacturers as well as by leading companies throughout American industry. It has been made possible by the good earnings of successful organizations over a period of years, which have provided and attracted the huge amount of new capital constantly needed to improve products, reduce costs, and expand jobs and payrolls.

Gold Prices and Currency Values

In recent weeks the perennial subject of gold has again been a topic of news, rumor, and controversy. Apart from recurring suggestions that the American gold price is too low and ought to be raised, the proposal has been made that the 1934 Gold Reserve Act be amended to permit the development of a free gold market, on the assumption that American gold producers would be able to get a better price than the $35 an ounce offered by the Treasury. Bills to accomplish this are in the hopper in Washington.

Legal barriers to internal trading in gold are down in many countries, and unregulated international traffic continues around the fringes of controls set up by governments to prevent it. On the other hand, the Swiss are contemplating legislation which would permit the introduction of new 25 and 50 franc gold coins for circulation at par with the paper currency.

At the same time the discount on forward sterling quoted in the New York foreign exchange markets has widened, accompanied by discussions of a possible devaluation of the pound sterling and associated currencies against gold and the dollar. The end of sellers' markets for overpriced goods has made the foreign exchange markets wary of currency changes and it is an open secret that gold and foreign exchange policies are under careful review in many capitals, in Europe and elsewhere.

Gold Production

Gold production is a unique industry which flourishes in hard times and wilts in years of general prosperity. At the onset of the world depression and under the influence of falling costs of production, world gold production turned strongly upward, rising from 19.2 million fine ounces in 1929 to 22.3 million in 1931. Subsequently, in a six-year epidemic of radical currency devaluations, beginning with Great Britain in 1931 and ending with France in 1936, the price of gold was raised, or allowed to rise in open trading, in every important financial or trading center in the world. Gold production thus received a second powerful stimulus and in 1940 reached 41 million ounces, more than double the 1929 figure and indeed the highest figure ever recorded, before or since. The amount paid for new gold more than trebled – from $400 million (at $20.67 an ounce) in 1929 to over $1,400 million (at $35 an ounce) in 1940.

During the war years, with rising costs and diversions of labor and materials to more essential needs, gold production was contracted and the subsequent recovery has been limited. Accurate data on Russian output are not available but it is estimated by the Bank for International Settlements that world production touched a low of 27 million ounces in 1945. Perhaps 28 million ounces were mined in 1948. The value of the estimated 1948 production, something short of

$1 billion for 28 million ounces, is a good way down from the $1,400 million for 40 million ounces in 1940. Still, it is substantially more than double the $400 million paid for 19.2 million ounces in 1929.

Gold-Producing Countries Today

For countries which rely regularly upon exports of newly-produced gold to balance their international accounts, the rise in production costs and the drop in production, from the prewar levels, are serious matters. Cost-price relationships are naturally worst where price inflation, war and postwar, has been greatest, and relatively best where inflation has been least. But almost everywhere marginal producers have been put out of business.

First and foremost in gold production, as the following table shows, is the Union of South Africa with better than 40 per cent of current world production. Along with British and Belgian possessions of Africa, the economy of the Union of South Africa is critically dependent upon the proceeds of sale of its gold as a means of payment for imports.

Gold Production
(In Thousands of Fine Ounces)

Countries	1929	1940	1945	1948
1. Union of South Africa	10,412	14,088	12,214	11,585
2. Canada	1,928	5,311	2,697	3,528
3. United States	2,208	6,003	929	2,099
4. U. S. S. R.	(included in estimate for "other countries")			
5. Australia	426	1,644	657	865
6. British West Africa	208	939	548	700e
7. Rhodesia	562	833	568	514
8. Mexico	652	883	499	500e
9. Colombia	137	632	507	335
10. Belgian Congo	173	555	343	316
Other countries (estimated)	2,494e	10,162e	8,038e	7,558e
Estimated world production	19,200e	41,000e	27,000e	28,000e

e—Estimated.

Source: The Eighteenth Annual Report of Bank for International Settlements, June, 1948, p. 105, gives figures for 1929, 1940 and 1945. 1948 figures are drawn from various official sources or are estimated.

The second largest gold producer is Canada with 12½ per cent of the world's total. The United States and Soviet Russia probably rank third and fourth, though Russian production figures are a subject of guesswork. American production, valued at $73 million in 1948, accounted for about 7½ per cent of the world's total and is of distinctly minor importance among our industries. Gold production is important, but by no means crucial, to Australia, Mexico and Colombia, and it brings in at least a million dollars a year to a considerable number of other countries.

Gold prices and currency valuations are always linked together because devaluation of a currency involves a rise in the price of gold paid to the producers. When a gold-producing country lowers the gold content of its currency, it makes an ounce of gold worth more in its own currency, and thus permits payment of a higher price to the miner as an offset to the higher level of his costs.

Nevertheless, up to now in the postwar era, few of the major gold-producing countries have devalued their currencies. Indeed, the number 2 country – Canada – in 1946 *upvalued* its currency by 10 per cent and reduced the price it paid for gold but subsequently has installed a system of subsidy payments on marginal production. Australia, the fifth largest producer, is providing special aid to depressed gold mining areas. Last year Colombia devalued its currency by 10 per cent and Mexico cut loose from its former parity and has allowed the price of gold to rise around 40 per cent. In February of this year the Union of South Africa, over the protest of the International Monetary Fund, announced an experimental sale, through a London bullion merchant, of 100,000 ounces of semi-processed gold and realized a price in U. S. dollars of $38.20 per fine ounce.

Talk of Devaluation

The main function of the price of gold, of course, is not that of evoking any given rate of production, but that of providing international means of payment, a base for security and trust in paper currencies and paper promises to pay, and a common denominator for comparisons of international price levels.

As is inevitable after the dislocations of a great war, it is pretty clear that a good many things, exchange rates included, are out of whack in the world economy. The International Monetary Fund, which has exchange rates and gold valuations under its special care, has freely recognized the need for exchange rate adjustments at the right time. In its Annual Report dated April 30, 1948, the Fund stated:

> The appropriate timing of an exchange rate adjustment will depend upon a variety of factors. The relation to export opportunities, which was emphasized when the initial par values were announced, is still of great importance. So long as an exchange rate does not hamper a country's exports, there is little to be said in present world conditions for altering it. There are indications, however, that in some countries the exchange rate is becoming a restraining factor on exports and that it is adding to the difficulty of earning convertible currencies.

Speaking in Minneapolis a week ago, and with particular reference to Marshall plan countries, Secretary of the Treasury Snyder stated:

> The Europeans must make greater effort to produce goods and offer to sell them in Western Hemisphere markets at competitive prices. In some cases this may require an adjustment of their exchange rates.

Most exchange rates prevailing today, Mr. Snyder noted, were adopted during and just after

the war. Since then there have been "important changes in the world situation". Among these changes, indeed just over the last six months, has been arrest of the inflationary surge here. Growing price consciousness, not only in the United States but in other "hard currency" areas as well, is putting the exporting capacity of European and other "soft currency" areas to the test. Much trade today, with and through Europe, would not and could not take place at the official exchange rates, and goes through only because leaks in the exchange control dikes make foreign currencies and goods available at a discount.

The reluctance, in many countries, to revalue currencies has been contrary to expectations. At the Bretton Woods conference five years ago the universal fear was a postwar rage of competitive currency devaluations. Now we have an agency, the International Monetary Fund, to "police" currency adjustments but, for various reasons, few countries have been disposed to make them.

As one explanation there has been at least a lingering hope abroad that the United States might devalue the dollar again. Internal political repercussions and considerations of national pride make statesmen hesitant to risk devaluation. If the United States should take the lead, a general round of devaluations would be made "respectable", even necessitous. In many cases a fixed exchange rate, together with an elaboration of exchange and import controls, is woven tightly into the structure of a centrally-planned society. Some countries would prefer to "regulate down" this price or that to suit a plan, but this approach, carried very far, involves the pains of internal deflation or the costs of export subsidy.

The U. S. Position on Gold

Secretary of the Treasury Snyder, repeatedly and vigorously, has denied that the American Government will consider any change in the American price of gold or the statutory gold content of the dollar. The ratio of the gold reserves of the Federal Reserve Banks to their note and deposit liabilities – the "Federal Reserve ratio" – is a shade above 50 per cent, double the minimum statutory requirement, and the Treasury has a billion of "free gold" which is not in the Federal Reserve figures. The aggregate gold stock runs to $24 billion and, while the growth this year has been small, the direction of movement is still inward.

The thesis has been advanced, however, that wartime inflation in governmental indebtedness has reduced "banking liquidity" to a dangerous point and that the valuation on monetary gold needs to be raised – possibly as much as doubled – as a compensation. Mr. W. J. Busschau, writing in the South African Journal of Economics for March, 1949, argues:

> . . . that because of the growth in incomes and credit (particularly long term obligations), increases in gold prices are necessary in order to obtain that degree of banking liquidity which will ensure the maintenance throughout the world of high levels of incomes and employment and that failure to increase gold prices sufficiently and in time will lead, as did the similar failure after World War I, to a severe credit deflation with its inevitable consequences of wide-spread unemployment and human misery.

Mr. Busschau uses the ratio of national gold stock to total money supply to show a decline in "liquidity", for the United States, from 46 per cent in 1938 to 22 per cent in 1948.

But do the prewar figures of the late thirties give a fair norm? Radical worldwide currency devaluations had sharply raised the ratio of gold to money supply, and credit expansion had nowhere near caught up. Never before had the United States enjoyed – or suffered – such excesses of liquidity. Barring this period, as the following table suggests, the ratio of gold to money supply has generally run around 15 per cent. The current 22 per cent is higher than anything experienced prior to the dollar devaluation in 1934. The lower limit of 10 per cent, a traditional danger point, was closely approached on some occasions, as in 1920, without rupturing gold convertibility.

U. S. Gold Stock Related to Money Supply
(Dollar Figures in Millions)

End of month	Money supply (Total demand deposits adjusted and currency outside banks)	U. S. gold stock	Ratio of gold stock to money supply
		(at $20.67 per ounce)	
June, 1914	$ 11,615	$ 1,604	13.8%
June, 1919	21,217	2,826	13.3
June, 1924	23;062	4,201	18.2
June, 1929	26,179	4,037	15.4
		(at $35 per ounce)	
June, 1934	21,353	7,856	36.8
June, 1939	33,360	16,110	48.3
June, 1944	80,946	21,173	26.2
June, 1947	108,433	21,266	19.6
March, 1949	106,000	24,311	22.9

Source of basic figures: Board of Governors of Federal Reserve System.

In short, it is difficult to find support, in figures such as these, for dollar devaluation. Such a move doubtless would boom gold mining as no other action would. But to what purpose? Gold is not mined today primarily for circulation. Indeed, in many of the "more advanced" countries, including our own, private holdings of gold in monetary forms are unlawful. Nowhere in the world today does gold circulate at an established legal parity with paper or silver currency. Where,

as here, a substantial national stock is concentrated in the hands of the Treasury and central banks, a rise in the price of gold, and in the valuation put on the national gold stock, would be simply an open license to inflate. In such an eventuality the assurance that a substantial gold stock is supposed to give – that the currency is secure – would be a pretty empty assurance. Indeed, if the gold stock were to be revalued every time the percentage dropped down the whole idea of a gold-covered currency makes nonsense. For then money could be printed without any restraint at all from the side of gold.

The Treasury and Federal Reserve authorities today have a capacity roughly to double the supply of dollars in circulation on the basis of the gold stock now held. If anyone *wanted* to embark on a deliberately inflationary course there would be no necessity to offer a higher price than the present $35 an ounce to gold producers.

A Free Gold Market?

For the past ten years the dollar, tied to gold at the ratio of $35 to an ounce of fine gold, has been an anchor of international monetary stability. We have had a severe dose of inflation, but when we bear in mind the extent to which rationing cuts down the buying power of money in so many countries abroad, the dollar has lost about as little purchasing power as almost any other currency, and far less than most. Nevertheless suggestions are constantly heard that the tie of the dollar to gold ought to be strengthened, and now it is proposed that a market should be created in which anyone could freely buy and sell gold, with the effect of providing a test of how good the dollar is.

The latter idea, which has gained rather wide currency in recent weeks, quite generally is predicated on the assumption that, in a free market here, gold would command a price well above the legal valuation of $35 an ounce. This assumption is not without support. Gold reportedly has been sold, directly for U. S. dollars, at prices around $45 an ounce in Saigon and in islands off the China coast. The South African Government realized $38.20 per fine ounce with its experimental sale. Moreover, gold coins of recognized value generally command somewhat higher premiums than U. S. paper currency in countries which do not effectively prohibit trading in both. Finally, gold in its natural state (placer gold), which legally can be traded in this country, has found a limited market at premium prices.

What sort of a premium gold, in some convenient, easily identifiable form, might enjoy in free trading here no one can positively say. It is significant that the demand for gold comes dominantly from foreigners, especially from areas where people have experienced severe inflation and have learned to distrust paper money. At the same time, supplies to the market have been restricted by governmental prohibitions on exports and much of the gold trade has been driven underground where risks demand liberal recompense.

Americans are not congenital gold hoarders and only turn to gold when other values seem threatened with utter collapse. They prefer to put their savings in productive forms of brick and mortar, interest-bearing investments, or dividend-paying stocks, rather than in the unproductive form of gold which offers no income but instead involves costs of storage. They do feel, as do foreigners, a vital reassurance in knowing that the dollar has a firm tie to gold.

Granted these conditions, and the confidence that the dollar enjoys, here and abroad, it is far from certain that gold would command any substantial premium over $35 an ounce in a free American market. If free imports and exports were allowed it is doubtful that there could be, under conditions as they have existed, much of any premium. The amount of dollars which foreign individuals have to offer in exchange for gold is far less than the amount of gold foreign governments have had to sell to get dollars. While some *millions* of privately-held dollars may have been used to buy gold at premium prices since the war, the amount of gold given up by foreigners in exchange for dollars, at the statutory rate of $35 an ounce, runs into the *billions*. In short, if foreign governments and central banks, which have been heavy sellers of gold for dollars, had sold their gold in free markets here, the Treasury almost certainly would have had to enter the market to maintain the price at $35 an ounce.

This general conclusion would destroy one principal argument for the establishment of a free gold market, and put another one in its place. It would deny the presumed premium price to producers. At the same time the disappearance of premiums here would put a damper on premium trading in the foreign markets and squelch uneasy rumorings about the dollar not being worth the 35th part of an ounce of gold.

Gold as a Basis for Trust in Currencies

The resurgence of gold, apart from the special interests of mining companies and communities, reflects the natural tendency of people to want

reassurance about their money. It is the proper function of gold in a monetary system to provide that reassurance.

The means for building back trust in currencies, where it has been lost, are twofold. First, as rapidly as feasible, legal restrictions can be eased on transactions in gold, within and between countries. There is probably no other formula for drawing gold out of hoards than assuring holders of the national currency that gold is available, at a stated price or parity, whenever they want it. Second, and *pari passu*, paper money inflation must be halted, government deficits replaced by surpluses, and the public credit restored or strengthened.

Paying the Piper

The above caption, from the leading article in the London "Economist" of April 9, summarizes in three words the real meaning of the budget presented by the British Chancellor of the Exchequer, Sir Stafford Cripps, to the Parliament last month.

Speaking, as the New York Times correspondent reported, "to a glum House of Commons and a disappointed nation," Sir Stafford "forcefully presented the unpalatable fact that, so long as Britain's expenditures for defense and social services continued at their present rate, there could be no substantial tax reduction."

Actual tax reduction contemplated in the budget amounted, all told, to only £19 million for this year and around £83.5 million for a full year. However, £33 million of these remissions represents merely a bookkeeping item in connection with reduction of duty on sugar and tea with corresponding limitation of food subsidies paid, while prices to consumers remain unchanged.

The biggest concession is that of £75 million in a full year for industry by doubling the initial allowance for installation of new plant and machinery. The duty on beer and wine is to be reduced, and a number of "obsolete or archaic" duties abolished at negligible cost.

On the other hand, there are to be increases on matches, telephone service, and betting, and increases in certain postal rates. The system of death duties is to be "simplified", with some remission of tax on the smaller estates, but an additional loading on the highest brackets sufficient to bring in, in total, another £20 million in a full year. This the Chancellor regards "as fully justified as a further step in our policy of the redistribution of the national wealth."

No changes were made in the stiff "purchase" (sales) taxes, which apply to a wide variety of retail goods at rates ranging from 33 1/3 to 100 per cent. In the punishing income tax (normal 45 per cent, and surtax 10 to 52½ per cent), there were only comparatively small adjustments in connection with unemployment, sickness, and maternity benefits. The British public continues to face the bleak prospect of paying something like 40 per cent of its total income in taxes, national and local, of one kind or another.

Reduction in Food Subsidies

Sir Stafford minced no words in discussing the rising trend of government expenditures. The main ingredients, he stated, are defense, food, and social services.

Dismissing the possibility of any marked reduction in defense costs "until there is a complete change in the international situation," Sir Stafford called attention to the increasing cost of food subsidies. Already, he indicated, the cost of these subsidies had risen to about £485 million and, if continued at the same rate during the coming year, might be expected to reach no less than £586 million, "all of which must be found by taxation on top of the other prospective increases."

"That," he declared, "just cannot go on."

Henceforward, any further rise in food costs must be added to prices. Accordingly, the Chancellor raised the price of meat 4 pence (about 6½ cents) a pound; cheese, 4 pence; margarine, a penny; and butter, 2 pence. This, together with the change in import duty on sugar and tea referred to earlier, would, he calculated, restrict the subsidy to £465 million (or £20 million less than their present rate) but increase the cost of living index by two points.

Cost of Social Services

On the cost of the social services – now accounting for roughly a third of the total government budget – Sir Stafford promised no reduction. He anticipated, on the contrary, increases.

Explaining that education, the health service, family allowances, national assistance, and the Government's contribution to national insurance will cost £736 million this year, he went on to assert, "the cost in 1949 is not the end . . . nothing can stop this, except the cutting down of the social services themselves, and that I do not believe anyone is prepared to recommend."

Can't "Have One's Cake and Eat It"

At the same time Sir Stafford did not shrink from pointing out that there is another side to the "welfare state." Again and again he hammered home "the unpleasant fact that these services must be paid for and they must be paid

for by taxation — direct and indirect." For example —

There are, of course, economies that we can make, and are making, in our administration, particularly as regards terminal expenditure from the war, and temporary services arising out of the war. But these economies are, in the main, in terms of fractions of a million, whereas the new expenditure as regards social services increases by tens of millions. We have, therefore, to face the fact that as long as the defense forces and the social services are maintained, whatever Government is in power, a very high rate of taxation will continue to be necessary.

• • • • •

When I hear people speaking of reducing taxation and at the same time see the costs of social services rising rapidly in response very often to the demands of the same people, I sometimes wonder whether they appreciate the old adage: "We cannot have our cake and eat it."

• • • • •

We have chosen, quite deliberately — and in this all parties have participated — to have our benefits in the form of extended social services . . . Each year, and year after year, we must provide, out of taxation, the money required for these services and for our defense . . . From a financial point of view, this means a large budget and high taxation.

With respect to the last quotation above, the critically inclined may indeed question whether the "choice" was so universal or so clear as Sir Stafford implies. As the London "Statist" of April 9 pointedly remarks —

Rather more than half the taxpayers voted against Socialism at the last election: to that section of the community there must be something galling in that passage of the budget speech which tells the nation that as it has chosen to have its benefits through new schemes of social and economic services it cannot have them through tax relief.

Likewise, the following from the "Economist" article cited earlier, seems apt:

It might be objected that the British people accepted each item in the bill separately, and that if the suggestion that the state would, in the name of their welfare, compulsorily spend 40 per cent of their incomes for them had ever been put to them as a general proposition, they might have taken a different line. But as a matter of practical politics, the decision has been taken and does not look like being reversed . . . It is certainly all to the good that Sir Stafford should begin to rub into the British people what they have let themselves in for.

A Redistribution of Wealth

Of course, what has been taking place in Britain is nothing more nor less than a gigantic redistribution of wealth, accomplished mainly through the instrument of taxation. That this has been, and is, the purpose of the Socialist Government, Sir Stafford makes no bones about admitting. As he said in his budget speech —

When we consider this matter (costs of defense and social services) we must bear in mind the very great and highly desirable redistribution of wealth that has already taken place in the last few years within our community.

To a large extent this has resulted from the provision of these extended social services, services for the least well-to-do. at the cost of the more well-to-do, thereby making more equal shares in the national income enjoyed.

The Limit to "Soaking the Rich"

Perhaps the most significant thing in the budget speech was the Chancellor's acknowledgment that this policy of "redistributing wealth" had reached the limit.

"There is", Sir Stafford told the Parliament and the British people, "not much more immediate possibility of the redistribution of the national income by way of taxation in this country." For the future, "we must rely rather upon the creation of more distributable wealth than upon the redistribution of the income that exists."

With taxation, local and national, now consuming 40 per cent of the British national income, "at that level the redistribution of income entailed in the payment for social services already falls, to a considerable extent, upon those who are the recipients of these services. We must, therefore, moderate the speed of our advance in the extended application of the existing social services to our progressive ability to pay for them by increases in our national income."

Two Important Questions

All this raises two very important questions.

One is whether, after going so far and promising people so much from the redistribution of wealth, it will now be possible for the Socialist Government to change the thinking of the British people and make them appreciate what Sir Stafford told them — namely, that taxation had already reached the limit of productiveness at the present level of national income, and that further expansion of the social services, or of other government costs, would have to be paid for through the combined efforts of all the people to increase the total of national wealth and income that could be distributed.

The protests and dismay with which the budget was greeted by members of the Chancellor's own Labor Party, who have been crying for relief from taxes (especially those taxes that reach

down into the lower income brackets) and from the rising cost of living, suggest that this job of re-education may not be an easy one. At the same time they raise some doubt again as to how many people have really chosen, "quite deliberately"—as Sir Stafford put it—to have their benefits in the form of extended social services rather than tax relief. It looks more as though people want the benefits all right, but want somebody else to pay for them.

The other question that is raised is whether the policy of redistributing wealth, and the burden of taxation that it entails, have not already gone too far. As Sir Stafford so significantly explained, further real progress in social welfare for the British people will be conditioned by the degree to which the sum total of wealth and income of the country can be increased. How much can this be done under a system and level of taxation that place so onerous a burden upon the creative energies of the population?

Dilemma of the "Welfare State"

The seriousness with which these questions are viewed by many thoughtful people in Britain today could hardly be put more effectively than by a leading article in the "Economist" of March 19. Declaring that "the height to which the price of government has risen in Britain today (40 per cent of the total of all incomes) would hardly be credible if they did not happen to be true," the writer continues:

> Every income in the country, large or small, pays over, on the average, eight shillings out of every pound of gross income in return for the benefits that government, central and local, confers upon the citizenry. This is a fantastic figure. There certainly never has been any country in the past that taxed itself to anything like the same extent. Nor, it is equally safe to say, is there any other country today that does the like . . .
>
> A tax proportion of 40 per cent is appalling from whatever angle it is approached. Moreover, it is far more likely to get worse than better . . . Expenditure is sure to rise: there is a growing defense program; social service expenditure under present enactments is due to increase quite largely; and it is doubtful whether the politicians will completely suspend their activities. On the other side of the comparison, some fall in the money total of the national income is almost sure to occur . . .
>
> This is the hideous prospect that faces the British people. Even though every item of government expenditure is approved in detail, it is almost certain that the ordinary man does not value the benefits of government, as against all the other good things of life, in the ratio of two to three. If the matter could ever be put to him in that way, he would certainly find the price of government far too high. Moreover, whether it is approved or not, any such rate of taxation, if continued for long, will be disastrous to the national economy. Any economy that depends to any extent at all upon individual effort and initiative must have some system of incentives and rewards. The Soviets, who depend less on individual efforts than the British system does, have long ago admitted the truth of this. Moreover, though they have carried social propaganda and the substitution of non-material rewards far further than any democratic state could possibly do, they also recognize the necessity of providing very large strictly monetary incentives as well. Idealists may dream of a state of affairs in which something other than individual material gain provides sufficient motive power to run the national economy. But those days have not yet appeared. A state that taxes away 40 per cent of all incomes, and much more of the incomes of the successful and the energetic, is killing the motive power that keeps it alive . . .

This is a grave indictment of the policy of the "welfare state." No doubt many in Britain will argue that the writer has painted too dark a picture. Yet the columns of the "Economist" are not given to irresponsible statements. To most people the lesson will be clear. Once the State has embarked upon the course of dispensing "free" services to the electorate it is extremely difficult to find a stopping place, or even to slow down the rate of extension of these services to the rate of growth of production upon which Sir Stafford placed so much stress.

THE NATIONAL CITY BANK OF NEW YORK


0·000,000
John Traveler
THE NATIONAL CITY BANK OF NEW YORK
SPECIMEN
UNITED STATES CURRENCY
20